No. 89-1542

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

BIZCAP, INC.,

Petitioner,

v.

ANTHONY P. OLIVE, Director of Virgin Islands Bureau of Internal Revenue, and GOVERNMENT OF THE VIRGIN ISLANDS,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF IN OPPOSITION

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BRIEF IN OPPOSITION

Respondents, Anthony P. Olive, Director of the Virgin Islands Bureau of Internal Revenue (hereinafter, "Respondent" or "the VIBIR"), and the Government of the Virgin Islands, oppose the Petition for a Writ of Certiorari. The Petition raises no issue worthy of review by this Court.

Respondents are not dissatisfied with Petitioner's presentations under the headings of Questions Presented, Parties to the Proceeding, Opinions Below, Jurisdiction, and Statutory Provisions Involved.

Respondents do challenge Petitioner's Statement of the Case. Therefore, Respondents submit the following Statement.

STATEMENT OF THE CASE

A. Background.

Petitioner was incorporated in the State of Delaware on March 31, 1983. (Pet. App. A-3[1]). Although Petitioner conducts a business in the Virgin Islands, Petitioner derives much of its income from investments in the mainland United States. (Pet. 4). During the years in issue (Petitioner's taxable years ended May 31, 1983, and May 31, 1984), Petitioner reported approximately $16.9 million of income from U.S. sources and approximately $17,000 of losses from Virgin Islands sources. (Pet. App. A-3-4).

At the time Petitioner filed its income tax returns for the years in issue, a Virgin Islands inhabitant company incorporated in the United States was obligated to pay taxes into the Virgin Islands treasury pursuant to two statutory sources. First, § 1 of the Naval Service Appropriation Act, 1922, Act of July 12, 1921, ch. 44, § 1, 42 Stat. 123 (1921) (codified, as amended, at 48 U.S.C.S. § 1397 (Law. Co-op. 1981 & Supp. 1989)),[2] established the "mirror tax" system, under which the U.S. Internal Revenue Code (hereinafter, the "I.R.C.") is "mirrored" in the Virgin Islands (hereinafter, the "mirror code") by substituting

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[1] "Pet." references are to the Petition for a Writ of Certiorari. "Pet. App." references are to the Appendices to the Petition.

[2] References to § 1 of the Naval Service Appropriation Act are to such section as in effect for the taxable years ended May 31, 1983, and May 31, 1984.

the words "Virgin Islands" for the words "United States". (Pet. App. A-5). Under the Virgin Islands mirror code, Petitioner was obligated to pay taxes to the Virgin Islands on its Virgin Islands source income and its income that was effectively connected with a Virgin Islands trade or business. I.R.C. §§ 881 and 882 (mirrored).

Second, § 28(a) of the Revised Organic Act of the Virgin Islands, Act of July 22, 1954, ch. 558, § 28(a), 68 Stat. 508 (codified, as amended, at 48 U.S.C.S. § 1642 (Law. Co-op. 1981 & Supp. 1989))[3] (hereinafter, "ROA § 28(a)" or "the inhabitant rule"), directed a U.S. corporation qualifying as an "inhabitant" of the Virgin Islands to satisfy its U.S. income tax obligations by paying its applicable tax under the I.R.C. to the Virgin Islands. The inhabitant rule provided, in pertinent part:

> [T]he proceeds of customs duties, the proceeds of the United States income tax, [and] the proceeds of any taxes levied by Congress on the inhabitants of the Virgin Islands . . . shall be covered into the treasury of the Virgin Islands . . . *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and *such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both*

[3] References to § 28(a) of the Revised Organic Act of the Virgin Islands are to such section as in effect for the taxable years ended May 31, 1983, and May 31, 1984.

> *within and outside the Virgin Islands into the treasury of the Virgin Islands. . . .*

ROA § 28(a) (emphasis added). The parties agree that, for the years in issue, Petitioner was an "inhabitant" of the Virgin Islands within the meaning of the inhabitant rule. (Pet. 4, n.2; Pet. App. A-3).

At the time Petitioner filed its returns for 1983 and 1984, the effect of the inhabitant rule was the subject of differing interpretations. Some taxpayers took the position that a U.S. corporation qualifying as a Virgin Islands inhabitant could avoid paying tax, to either the United States or the Virgin Islands, on its U.S. source income that was not effectively connected with a Virgin Islands trade or business. (Pet. App. B-3).[4]

Petitioner filed its returns for 1983 and 1984 on this basis. It reported U.S. source income of over $16.9 million for this period, but paid no tax on that

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[4] These taxpayers advanced the following two arguments: (Pet. App. A-7)

1. Under the inhabitant rule, a U.S. corporation qualifying as a Virgin Islands inhabitant could satisfy its entire U.S. income tax obligation simply by filing a tax return with the Virgin Islands and paying to the Virgin Islands the corporation's tax as determined under the mirror code.

2. Under the mirror code, a U.S. corporation was not subject to Virgin Islands tax on U.S. source income that was not effectively connected with a Virgin Islands trade or business, since, for mirror-code purposes, a U.S. corporation was a "foreign corporation" and U.S. source income was "foreign source income." (Under the I.R.C., a foreign corporation pays tax only on income that is derived from sources in the United States or is effectively connected with a trade or business in the United States. I.R.C. §§ 881 and 882.)

income to either the United States or the Virgin Islands. On November 7, 1985, Respondent (which took the position that a U.S. corporation qualifying as a Virgin Islands inhabitant owed tax to the Virgin Islands on its worldwide income) issued to Petitioner a statutory notice of deficiency asserting tax deficiencies and penalties in the respective amounts of $5,117,758 and $767,664. (Pet. 9; Pet. App. A-3-4). On January 24, 1986, Petitioner filed a petition for redetermination of the asserted tax deficiencies in the District Court of the Virgin Islands.

Also on January 24, 1986, the District Court of the Virgin Islands decided *Danbury, Inc. v. Olive*, 627 F. Supp. 513 (D.V.I. 1986), holding that a U.S. corporation qualifying as a Virgin Islands inhabitant owed no tax to the Virgin Islands on U.S. source income. On January 28, 1986, the VIBIR appealed the district court's decision in *Danbury* to the United States Court of Appeals for the Third Circuit.

On October 22, 1986, while the *Danbury* appeal was pending and before the district court reached its decision in this case, Congress repealed the inhabitant rule by enacting § 1275(b) of the Tax Reform Act of 1986, Pub. L. 99-514, § 1275(b), 100 Stat. 2085, 2598 (1986) (codified at I.R.C. § 7651(5)(B) (CCH 1989)) (hereinafter, "TRA 86"). Under the new law, "a corporation such as Danbury [*i.e.*, a U.S. corporation qualifying as a Virgin Islands inhabitant] pays its taxes under the mirrored Code to the [VIBIR] and pays its taxes under the [I.R.C.] to the Internal Revenue Service." *Danbury, Inc. v. Olive*, 820 F.2d 618, 625 (3d Cir. 1987).

The applicable effective-date provision, TRA 86 § 1277(c)(2), 100 Stat. 2601, made the repeal both

prospective (*i.e.*, applicable to taxable years beginning after 1986) and partially retroactive (*i.e.*, applicable to certain taxable years beginning before 1987). Petitioner, however, was granted an exception from the retroactive application of the repeal, through TRA 86 § 1277(c)(2)(D), 100 Stat. 2601. Petitioner's exception states:

> (D) EXCEPTION—In the case of any pre-1987 open year, the amendment made by section 1275(b) shall not apply to [Petitioner].[5]

On June 5, 1987, the United States Court of Appeals for the Third Circuit reversed the district court's decision in *Danbury*, holding that, under the plain language of the inhabitant rule (as in effect prior to its repeal)—

> Danbury owed the [VIBIR] (1) Virgin Islands taxes on Virgin Islands-generated income, under the Naval Appropriations Act, and (2) U.S. taxes on worldwide income, figured with a tax credit for any Virgin Islands or other foreign taxes paid, under Section 28(a).

Danbury, Inc. v. Olive, 820 F.2d 618, 623 (3d Cir. 1987), *cert. denied*, 484 U.S. 964 (1987).

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[5] The exception does not actually refer to Petitioner by name, but refers to "any domestic corporation if (i) during the fiscal year which ended May 31, 1986, such corporation was actively engaged directly or through a subsidiary in the conduct of a trade or business in the Virgin Islands and such trade or business consists of business related to marine activities, and (ii) such corporation was incorporated on March 31, 1983, in Delaware." TRA 86 § 1277(c)(2)(D), 100 Stat. 2601. The parties agree that this language refers to Petitioner. (Pet. App. A-10).

For purposes of this Petition, Petitioner concedes that the Third Circuit's decision in *Danbury* was correct and that the district court in *Danbury* had misconstrued the inhabitant rule as in effect prior to 1987. (Pet. 12 n.7[6]).

B. The Decisions Below

In view of the court of appeals' holding in *Danbury*, Petitioner did not argue in the proceedings below that Petitioner's U.S. source income was exempt from Virgin Islands taxation by reason of ROA § 28(a) and the mirror code. Instead, Petitioner asserted that such income was exempt from Virgin Islands taxation by reason of TRA 86 § 1277(c)(2)(D), Petitioner's exception to the retroactive repeal of the inhabitant rule.

The Virgin Islands District Court agreed with Petitioner's assertion, reasoning that Congress, in enacting TRA 86 § 1277(c)(2)(D), must have intended to grant Petitioner an exemption from both U.S. and Virgin Islands taxes for 1983 and 1984 (Pet. App. B-5-9).

The United States Court of Appeals for the Third Circuit reversed the decision of the district court, holding that (i) the plain language of TRA

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[6] Petitioner also characterizes the court of appeals' holding in *Danbury* as "dicta" and states that the court of appeals below misinterpreted its prior decision in *Danbury* by viewing that decision "as binding precedent on the state of pre-1987 (*i.e.*, pre-Tax Reform Act) law." (Pet. 10-11, Pet. 11 n.7). Respondent believes Petitioner's characterization of the *Danbury* decision constitutes a misstatement of the law which, pursuant to Rule 15.1, Respondent must call to the Court's attention. The court of appeals below correctly interpreted its prior decision in *Danbury*, which expressly reversed the district court's holding under the inhabitant rule in that case.

§ 1277(c)(2)(D) simply treated Petitioner, for the taxable years in issue, as though the inhabitant rule had not been repealed, (Pet. App. A-10), and (ii) under the court of appeals' holding in *Danbury*, the inhabitant rule required Petitioner to pay tax to the Virgin Islands on Petitioner's U.S. source income. (Pet. App. A-11). The court observed that the drafters of TRA 86 § 1277(c)(2)(D) could have stated explicitly that Petitioner was exempt from tax liability on U.S. source income for the years in issue, but that, instead, "Congress chose clear language which linked [Petitioner's exception] to the application of the Virgin Islands law prior to the repeal of the inhabitant rule. We are not at liberty to ignore the plain language of a congressional enactment." (Pet. App. A-11-12). The court of appeals concluded: "[T]he exception in § 1277(c)(2)(D) of the Tax Reform Act of 1986 exempts [Petitioner] from the retroactive effect of the Act with respect to pre-1987 open years. However, the result is to hold [Petitioner] liable to the [VIBIR] for the pre-1987 tax years for which the [VIBIR] filed a deficiency notice within the statute of limitations." (Pet. App. A-3).

This Petition for a Writ of Certiorari followed.

REASONS FOR DENYING THE WRIT

A. The Decision Below Raises No Issue Worthy of Review by This Court.

This case involves a simple "grandfather" rule that applies only to Petitioner and has no continuing effect for years after 1986. The court of appeals below decided the case correctly on the basis of the plain language of the statute, and the statute has not been construed in a conflicting manner by any other circuit.

This Court has stated, in several recent decisions regarding the interpretation of statutes, that, absent a "clearly expressed legislative intention to the contrary," the language of the statute itself "must ordinarily be regarded as conclusive," *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980), cited with approval in *United States v. James*, 478 U.S. 597, 606 (1986), and *Burlington Northern Railroad Company v. Oklahoma Tax Commission*, 481 U.S. 454, 461, (1987). The Court also has stated: "When we find the terms of a statute unambiguous, judicial inquiry is complete, except 'in "rare and exceptional circumstances." ' " *Rubin v. United States*, 449 U.S. 424, 430 (1981), cited with approval in *United States v. James*, *supra*, at 606, and *Burlington Northern Railroad Company v. Oklahoma Tax Commission*, *supra*, at 461.

Consistent with the foregoing principles, the court of appeals' decision below is based squarely on the plain language of the statutory provision in question. The court of appeals emphatically stated:

> The *plain language* of the exception only exempts [Petitioner] from the retroactive effect of the tax law change. . . . Congress chose *clear language* which linked [Petitioner's] exception to the application of the Virgin Islands law prior to the repeal of the inhabitant rule. We are not at liberty to ignore the *plain language* of a congressional enactment. *See Central Trust Co. v. Creditor's Committee*, 454 U.S. 354, 360 (1982) (per curiam), *citing*, *Caminetti v. United States*, 242 U.S. 470, 485 (1917).

(Pet. App. A-11-12) (emphasis added).

In sum, the court of appeals below followed the decisions of this Court and applied the plain language of an unambiguous statute.

B. This Case Does Not Raise the Question Presented in the Petition.

In light of the limited applicability of the decision itself—the decision that TRA 86 § 1277(c)(2)(D) does not exempt Petitioner from paying tax to the Virgin Islands for 1983 and 1984 on Petitioner's U.S. source income—Petitioner asserts that the court of appeals' application of the statute somehow raises an "important and recurring question" of statutory construction. (Pet. 13). This case, however, does not raise the issue framed in the Question Presented portion of the Petition.

The sole Question Presented in the Petition is:

> Should a statute that defines rights and obligations by reference to pre-existing legal rules be presumed to require application of those rules as they were understood by Congress at the time of enactment of the new statute, without regard to post-enactment judicial interpretation of the prior law?

This case does not raise Petitioner's question. First, the statutory provision in question—TRA 86 § 1277(c)(2)(D)—does not define rights and obligations "by reference to pre-existing legal rules." Second, the record does not support Petitioner's assertion that, at the time of enactment of TRA 86, Congress intended to adopt the *Danbury* district court's interpretation of the inhabitant rule.

1. The Statutory Provision in Question Does Not Define Rights and Obligations "by Reference to Pre-Existing Legal Rules."

TRA 86 § 1277(c)(2)(D), is, pure and simple, a "grandfather rule." That is, when Congress amended the tax rules applicable to inhabitants of the Virgin Islands and generally provided that the change would apply for both post-1986 taxable years (TRA 86 § 1277(c)(2)(A)(i)) and "pre-1987 open years" (TRA 86 § 1277(c)(2)(A)(ii)), Congress granted to Petitioner an exception from the second half of the effective-date rule, thereby postponing the effect of the amendment, as to Petitioner, until Petitioner's first post-1986 taxable year. The statute did not affirmatively provide how Petitioner would be treated for pre-1987 open years, nor did it affirmatively define Petitioner's rights and obligations by reference to any standard—pre-existing or otherwise. The statute simply provided that Petitioner would not be subject to the newly enacted provision for such years.

A simple grandfather rule like TRA 86 § 1277(c)(2)(D) is a far cry from a statute that affirmatively "defines rights and obligations by reference to pre-existing legal rules," such as the statutes involved in the two principal cases relied upon by Petitioner.[7] Section 3(a) of the Longshoremen's and Harbor Workers' Act of 1927, ch. 509, 44 Stat. 1424 (amended by Pub. L. No. 92-576, 86 Stat. 1251), construed in *Parker v. Motor Boat Sales, Inc.*, 314 U.S. 244 (1941), explicitly provided that compensation un-

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[7] Petitioner correctly concedes that *Broum v. GSA*, 425 U.S. 820 (1976), which Petitioner also cites, is not on point "because the statute at issue did not define rights and obligations in terms of prior law." (Pet. 20).

der that Act was limited to those circumstances in which "recovery for the disability or death through workmen's compensation proceedings may not validly be provided by State law." (*See* Pet. 17). Similarly, § 115(f)(1) of the Revenue Act of 1938, 52 Stat. 447, 497, construed in *Helvering v. Griffiths*, 318 U.S. 371 (1943), stated: "A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as income to the shareholder to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution." 318 U.S. at 372.

Each of these statutory provisions *expressly* incorporated specific pre-existing legal rules, the content of which was an *essential* element of the meaning of the provision. Neither of these provisions could be understood without inquiring into the content of the pre-existing rules incorporated therein. TRA § 1277(c)(2)(D), on the other hand, is simply an effective-date provision that stands on its own. That provision essentially states: "The new law shall not apply," a statement that is easily understood without any knowledge of the content of the old law.

2. The Record Does Not Support Petitioner's Assertion That, at the Time of Enactment of TRA 86, Congress Intended to Adopt the *Danbury* District Court's Interpretation of the Inhabitant Rule.

The Question Presented in the Petition would be raised only in a case in which Congress, in enacting a new statute, clearly intended to adopt a particular interpretation of prior law which was subsequently rejected by the courts. Recognizing this, Petitioner states:

> [W]hen Congress enacted section 1277(c)(2)(D), the only court decision construing the interplay between the relevant federal and Virgin Islands tax statutes was [the district court's decision in *Danbury*]. Congress, the [VIBIR], and Petitioner were all fully aware of the existence of this decision .... Accordingly, it is unnecessary in this case to consider how to construe statutes of this character when there are conflicting—or no—prior judicial interpretations. *Rather, we are concerned only with cases in which the pre-enactment legal rules that bear on the interpretation of a statute are well understood.*

(Pet. 15, emphasis added). These statements imply that, at the time of enactment of TRA 86, (i) the rules applicable to Petitioner, *as construed by the district court in Danbury*, were "well understood" to be the law, and (ii) Congress itself believed those rules, as so construed, to be the law. Both of these propositions, however, are refuted by the record in this case.

a. The District Court's Interpretation of the Inhabitant Rule in *Danbury* Did Not Represent "Well Understood" Law at the Time TRA 86 Was Enacted.

When the Third Circuit Court of Appeals reversed the district court's decision in *Danbury*, it made the following comments about the district court's interpretation of the pre-TRA 86 inhabitant rule:

> The only interpretation inconsistent with our view [that the inhabitant rule requires a Virgin Islands inhabitant to pay tax to the Vir-

> gin Islands on its worldwide income] that Danbury can produce, other than its own assertions, is found in a private publication, read mainly by tax lawyers, that describes the interpretation now argued by Danbury as a "tax haven theory." [Citations omitted.] Danbury is the first taxpayer to raise the tax-loophole theory in court—over thirty years after Congress enacted the statute at the heart of Danbury's contentions. This attempt to avoid assessment of an income tax deficiency apparently arose from the "creative" analysis offered by the article . . . rather than from a rational consideration of the actual taxing and administrative statutes.

Danbury, *supra*, 820 F.2d at 625. The court of appeals reversed the district court's holding in *Danbury* on the basis of the "plain" and "unambiguous" language of the inhabitant rule. 820 F.2d at 622-24. Petitioner's assertion that the *Danbury* district court's interpretation of the inhabitant rule represented "well understood" law flies in the face of the court of appeals' finding that the district court's interpretation had no support other than a private publication (which itself described the interpretation as a "tax haven *theory*") and was contrary to plain and unambiguous statutory language.

Moreover, the IRS' interpretation of ROA § 28(a), which was clearly and publicly stated, *in 1980*, in Revenue Ruling 80-40, 1980-1 C.B. 175, also was directly contrary to the district court's decision in *Danbury*. Revenue Ruling 80-40 states:

> Congress, in section 28(a) of the R.O.A., made it clear that [non-Virgin Islands source

> income of U.S. corporations qualifying as Virgin Islands "inhabitants"] would not escape taxation by using the words "paying their tax on *income derived from all sources both within and outside the Virgin Islands* into the Treasury of the Virgin Islands." . . . Thus, in effect, [a U.S. corporation that is an "inhabitant" of the Virgin Islands] is taxed as if it were a Virgin Islands corporation and satisfies both its United States and Virgin Islands income tax obligations by paying the Virgin Islands territorial income tax on its income from all sources.

(Emphasis in original). Revenue rulings are "administrative in nature and do not have the force of law," *Becker v. Commissioner*, 751 F.2d 146, 149 (3d Cir. 1985), but, as the court of appeals stated in *Danbury*, "here they do provide persuasive evidence of others reading Section 28(a) as this court reads it." 820 F.2d at 625. Rev. Rul. 80-40 further undermines Petitioner's assertion that the district court's decision in *Danbury* represented "well understood" law at the time of enactment of TRA 86.

Finally, at the time of enactment of TRA 86, the district court's decision in *Danbury* was on appeal to the Third Circuit Court of Appeals. That decision cannot, in the face of the plain and unambiguous language of the inhabitant rule itself, have been considered "well understood" law.

b. At the Time TRA 86 Was Enacted, Congress Had Not Adopted the *Danbury* District Court's Interpretation of the Inhabitant Rule.

All three of the official committee reports explaining the provisions of TRA 86 indicate that, in Con-

gress' view, Virgin Islands inhabitants were required to pay tax to the Virgin Islands on their worldwide income. The reports of the House Ways and Means Committee and the Senate Finance Committee both contain the following sentence describing the "present law" applicable to Virgin Islands inhabitants:

> Under section 28(a) of the Revised Organic Act of the Virgin Islands, as interpreted by the courts, an "inhabitant" of the Virgin Islands is exempt from U.S. tax *as long as the inhabitant pays tax to the Virgin Islands on its worldwide income.*

H.R. Rep. No. 426, 99th Cong., 2d Sess. 483 (December 7, 1985), S. Rep. No. 313, 99th Cong., 2d Sess. 476 (May 29, 1986) (emphasis added). Similarly, the report of the Committee on Conference states: "An 'inhabitant' of the Virgin Islands pays tax to the Virgin Islands on its worldwide income, but pays no U.S. tax." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-679 (September 18, 1986).

Moreover, the Senate Finance Committee Report explicitly acknowledged the district court's decision in *Danbury* by stating only that that decision "leaves open *the possibility* that the interaction of V.I. and U.S. tax law exempts from all tax, in both the United States and the Virgin Islands, U.S. source income earned by a U.S. corporation qualifying as a V.I. inhabitant." S. Rep. No. 313, 99th Cong., 2d Sess. 478 (May 29, 1986) (emphasis added). As noted above, the district court's decision in *Danbury* was appealed on January 28, 1986, and ultimately was reversed on June 5, 1987.

The committee reports explaining the provisions of TRA 86 would not contain these statements if Congress had believed that U.S. corporations qualifying as Virgin Islands inhabitants were exempt from any tax on their U.S. source income.

CONCLUSION

The decision below was correctly decided, does not conflict with any precedent of this Court or, indeed, of any other court, and does not raise any issue of sufficient importance to warrant this Court's attention. Moreover, this case does not raise the Question Presented in the Petition. Thus, no basis exists for granting the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit. Respondent respectfully requests that the Petition be denied.

Respectfully submitted,

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